

# Annual Investor Report 2017

## MFG Asset Management Global Equity Strategy

Dear investor,

I am delighted to write to you on the 10th anniversary of the launch of the MFG Asset Management Global Equity Strategy. We view the return achieved over the past 10 years of 11.7% p.a. before fees in US dollars as more than satisfactory, and above our long-term objective.

We have remained true to our investment philosophy over the past decade as we believe that sticking to our investment beliefs and process materially increases the prospects of delivering satisfactory investment returns over time while significantly reducing downside risk.

The following sets out the annual investment results of the MFG Asset Management Global Equity Strategy over the past decade in comparison with the returns on the MSCI World Index. It shows the cumulative returns of the Strategy and the MSCI World Index over this period in different ways.

**Tables 1 & 2: Performance to 30 June 2017 in US dollars (before and after fees) since inception.**

Yearly results to June 30 (% \$US)				
Yearly results to June 30	Global Equity Composite - gross (%)	Global Equity Composite - net (%)	MSCI World Net Total Return Index (%)	Excess return (gross) (%)
2007-08	-5.1	-5.8	-10.7	5.6
2008-09	-8.5	-9.3	-29.5	21.0
2009-10	20.6	19.7	10.2	10.4
2010-11	31.7	30.7	30.5	1.2
2011-12	15.5	14.6	-5.0	20.5
2012-13	27.3	26.3	18.6	8.7
2013-14	16.8	15.9	24.0	-7.3
2014-15	7.4	6.5	1.4	5.9
2015-16	-1.6	-2.4	-2.8	1.2
2016-17	20.7	19.7	18.2	2.5

Annual compound results (% \$US p.a.)				
	Global Equity Composite - gross (%)	Global Equity Composite - net (%)	MSCI World Net Total Return Index (%)	Excess return (gross) (%)
1 year	20.7	19.7	18.2	2.5
3 years	8.4	7.6	5.2	3.2
5 years	13.6	12.7	11.4	2.3
7 years	16.3	15.4	11.4	5.0
10 years/since inception	11.7	10.8	4.0	7.7

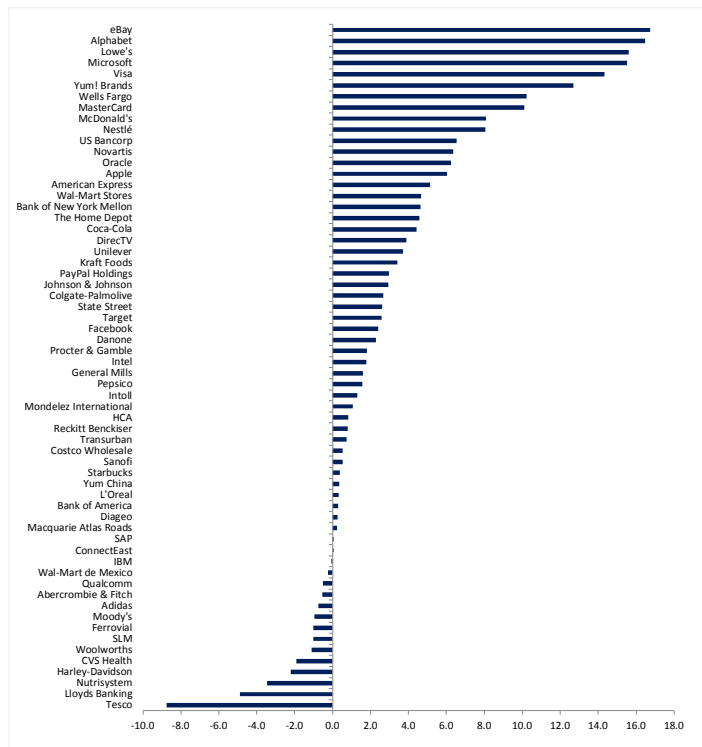
It is important to note that our portfolio is different from the MSCI World Index – we typically hold about 25 high-quality investments whereas the MSCI World Index comprises more than 1,600 companies. As our portfolio looks nothing like the MSCI World Index, it is inevitable that we will periodically underperform this benchmark. We do not pat ourselves on the back when we outperform the MSCI World nor do we lose much sleep when we underperform the MSCI World over the short term. It is the absolute return that we achieve over the longer term that matters.

In our view, whether or not we achieve our investment objective over the longer term comes down to the frequency of investment mistakes. We will always be candid with our investors when we make mistakes and hopefully learn from them. The following chart shows the contribution from each investment to the total investment returns of our Global Equities Strategy over the past 10 years.

The total gross cumulative return of the strategy has been +202% over the past 10 years and of 62 total investments since the strategy's inception, 48 investments have contributed positively (+220%) to returns, while 14 investments have detracted (-27%) from performance. Clearly, the average loss-making investment has detracted significantly less than the average gain-making investment. It is interesting to note that the contributions of eBay and Alphabet (+16.7% and +16.5% respectively), the portfolio's best performers over the 10 years, more than offset the losses from detracting investments. While we are disappointed with a few of the investments

we have made over the past 10 years (most notably Tesco and Nutrisystem), even the worst mistakes have not been significant in the context of the overall return of the strategy.

**Chart 1: The contribution to returns by stocks since inception, 10 years to 30 June 2017 in US dollars.**



## Reflections

It has been an extraordinary 10 years. Over this period, stock markets have experienced a 'peak-to-peak cycle'. The S&P 500 Index reached 1,576.09 on 11 October 2007 and then bottomed at 666.79 on 6 March 2009 (a 58% fall from the high) and closed at 2,423.41 on 30 June 2017, 54% above the previous peak and up 263% from its low on 6 March 2009. Over this period, we have seen:

- The collapse of Bear Stearns in March 2008
- The failure of Lehman Brothers in September 2008
- The near meltdown of the world's financial system after the collapse of Lehman Brothers
- The election of President Barack Obama on 4 November 2008
- A massive multi-year intervention into markets by the world's major central banks. As at 30 June 2017, the US Federal Reserve, the European Central Bank, the Bank of Japan and the Bank of England have made net asset purchases of US\$10.4 trillion since the collapse of Lehman Brothers
- Three bail-outs for Greece and fears of the collapse of the euro in 2011 and 2012 as bond yields in southern Europe rose precipitously
- The rise of ISIS
- The continued ascent of China economically and

geopolitically. Over the past decade, China has embarked upon an extraordinary credit expansion to drive economic growth

- The vote on 23 June 2016 for the UK to leave the European Union
- The election of President Donald Trump on 8 November 2016
- The rising nuclear threat posed by North Korea.

As I think back through these events, I reflect on three important lessons:

- **Capital preservation is paramount** – Always be aware of the inherent risks you are exposed to because a major event could strike at any time.
- **Understand the difference between investment and speculation** – To be an investor is to have a mindset that seeks to understand the intrinsic value of a business in order to assess whether or not you will generate an acceptable rate of return over time by buying a share of the business at the prevailing price. Speculation is the opposite. It involves trading in anticipation that a share price will rise or fall over a short time horizon, typically less than 12 months.
- **Quality and compound interest are the gifts that keep giving** – We believe that investing in a portfolio of high-quality businesses with high returns on capital and holding them for an extended period allows the power of compound interest to work its magic over time. Albert Einstein described compound interest as the eighth wonder of the world.

As an investor, it is critical to remain unemotional when making investment decisions. While this is an easy concept to understand, it is difficult in practice. As I have observed previously, evolution did not have investing in mind when designing the biology of the human body. In times of extreme stress (like during a market crash), the adrenal gland releases the adrenaline hormone that causes our heart rate and blood pressure to increase. If we were still cavemen about to be attacked by a wild animal, the release of adrenaline would no doubt have enormous benefits. However, as an investor you need to remain extremely calm and rational during times of immense stress and you do not want your body to release adrenaline. It is not surprising that so few investors take advantage of periods of extreme market pessimism. Conversely, during an extended bull market (which we appear to be experiencing at present), the human brain will likely release endorphins, creating a sense of happiness and ease as it watches ever-increasing share prices and rising perceived prosperity. Warren Buffett has superbly summed this up: "The line separating investment and speculation, which is never bright and clear, becomes blurred still further when most market participants have recently enjoyed triumphs. Nothing sedates rationality like large doses of effortless money. After a heady experience of that kind, normally sensible people drift into behaviour akin to that of Cinderella at the ball. They know that overstaying the festivities – that is, continuing to speculate in companies that have gigantic valuations relative

to the cash they are likely to generate in the future – will eventually bring on pumpkins and mice. But they nevertheless hate to miss a single minute of what is one helluva party. Therefore, the giddy participants all plan to leave just seconds before midnight. There's a problem, though: They are dancing in a room in which the clocks have no hands."

Another important reflection over the past 10 years is the arrival of digital-platform companies. Today, digital-platform businesses comprise seven of the world's top-10 companies by market capitalisation (Apple, Alphabet (the parent of Google), Amazon.com, Facebook, Microsoft, Tencent and Alibaba). These businesses are a new form of enterprise and are almost dream businesses from an economic perspective, as they earn nearly infinite returns on capital (as they essentially require no ongoing equity capital) and have extraordinary competitive advantages. Their competitive advantages are driven by the network effects of having one-billion-plus audiences and having access to vast amounts of data. For many of these businesses, it appears that their competitive advantages strengthen daily. I am reminded of the ABBA song, 'The winner takes it all', when thinking of these companies.

An emerging reflection (and one that I suspect will recur frequently over the next decade) is the likely impact of emerging technologies such as artificial intelligence and new forms of manufacturing such as 3D printing on economies, businesses and society. While the past 10 years have been challenging, I believe coming ones could be more demanding for investors because past investment paradigms might no longer hold as technology disrupts many business models and creates businesses in fields yet to be conceived.

A final reflection is my strong belief that rational investors should be guided by the simple principle of seeking to generate a satisfactory return on their capital over time while minimising the risk of a permanent capital loss. Unfortunately, many people lose sight of the fact that the two elements of this principle are equally important by becoming complacent in favourable markets, often chasing the latest investment fad or perceived higher returns without thinking through the accompanying risks.

## Passive investing and disruption

There appears to be an accelerating trend towards low-cost index or passive investing.

The father of low-cost index investing, Jack Bogle, deserves the investment equivalent of a sainthood as he has commoditised buying the market index at a very low cost. Bogle is a hero of mine for the service he has done for society by lowering the cost of accessing the market index to negligible levels. I have named the office adjacent to my desk (open plan) the 'Bogle room' in honour of Jack. It serves to remind me that we are here to serve our clients and, as active managers, we must do something fundamentally different, rather than mimic or closely follow the market index.

It is important for investors to understand what they are buying when they invest in an index fund. They are buying all the constituent companies in the index. If, for example, investors buy an S&P 500 Index fund, they are gaining an exposure to

500 of the largest US companies, which represent about 80% of the market capitalisation of all companies listed in the US. Over time, the S&P 500 Index, on average, will produce a return approximately equal to the underlying earnings growth of all companies in the index, plus the dividends paid by all companies in the index, less the negative return of companies that fail, less the fees charged by the index provider. To earn reliable absolute returns from tracking a market index, the following factors must hold:

- Over the long term, the long-term price/earnings multiple remains fairly constant for the vast majority of companies in the index; and
- The failure rate of companies in the index remains fairly static.

Historically, these premises have held for the major market indices and investors have achieved satisfactory returns from index investing.

In our opinion, there is a material risk that technological advances and business-model disruptions over the next 10 to 20 years will reduce the value of many companies in the major market indices. (This will be driven by lower future earnings and lower price-earnings multiples.)

We believe a meaningful proportion of companies will cease to exist over the next 20 years as the inherent failure rate of businesses increases. More obvious examples of businesses that face possible extinction over the next 20 years include car manufacturers/automotive suppliers, oil and gas companies, coal miners, many retailers, media/cable companies and shipping companies.

Additionally, a large proportion of businesses could have their business models fundamentally disrupted over the next 10 to 20 years. In our view, many of the large consumer brand companies could be vulnerable.

In thinking about the possible impact of business model disruption on the valuation of businesses, I often think about the long-term prospects of a consumer stalwart like Procter & Gamble (P&G).

P&G is the world's leading household products company. Its portfolio of consumer brands appears formidable because its brands include Tide, Fairy, Dawn, Gillette, Pampers, Pantene, Head & Shoulders, Herbal Essences, Tampax, Always, Crest, Oral B, Vicks, Old Spice, Olay, Bounty and Charmin. A fundamental reason for the strength of P&G's economic moat has been the power of the brand-based business model, which combines traditional advertising with conventional retailing.

As the world's largest advertiser, P&G has the largest share of shoppers' minds. Owning the number one or two brands in core categories gives P&G the preeminent shelf space with traditional retailers such as Walmart and Tesco. This business model has resulted in a virtuous circle for brand owners such as P&G. We believe that new advertising and distribution models driven by businesses such as Facebook, Google, YouTube, Amazon and China's Alibaba are slowly breaking apart the business models of some of the dominant consumer brands. Facebook, Google and YouTube are eroding the barriers to

entry in advertising, and emerging brands can quickly gain enormous exposure. More importantly, the large consumer platform businesses such as Amazon and Alibaba are likely to seek to disintermediate consumer brands. We believe that for many of P&G brands (like cleaning agents Tide, Fairy, Dawn, and for products like paper towels (Bounty) and toilet paper (Charmin)), it will be relatively easy for consumer platforms to disintermediate these products over time and replace them with, say, Amazon-branded products. Importantly, over time many of these products are less likely to be purchased in traditional retail outlets but rather be restocked automatically via a platform. These platforms will be integrated with the Internet of Things (connected devices like washing machines) and powered by voice-operated digital assistants such as Amazon's Alexa. We can see a future where regular household items are automatically replenished by services such as the 'Fulfillment by Amazon' program. It is not far-fetched for the following interaction to occur in the near future:

**Alexa digital assistant:** *"Good morning, Hamish. I am going to place the order for the weekly shop today."*

**Hamish:** *"Oh, good. What are you ordering?"*

**Alexa:** *"I will order regular items that are running low. If you don't mind, I have a few ideas that should save you \$20 this week and hundreds of dollars per year. I notice that you have regularly ordered Tide washing detergent, Fairy dishwashing tablets and Charmin toilet paper. I would like you to try some great Amazon products to replace these brands."*

**Hamish:** *"I am not sure I want to do this. I have been using these brands for years."*

**Alexa:** *"Look Hamish, I don't want to offend you but you have been overpaying for these products as you have been paying for all the advertising on these brands. I can assure you the Amazon product quality is exceptional. If you are not 100% happy, please return any of these products at any time and I will provide a full refund."*

**Hamish:** *"I am a little unsure but will give these products a go."*

**Alexa:** *"Good to hear, Hamish. I know you won't look back. You are on your way to saving hundreds of dollars per year with these few changes. I would hate to see a person with such a strong Scottish name not taking advantage of substantial savings. You had better run as you have a meeting at work in 30 minutes."*

**Hamish:** *"Oh, I am running late. Please order me an Uber."*

**Alexa:** *"Done. Uber will be here in five minutes. Have a great day."*

I believe the preceding dialogue will prove realistic enough and shows the power of platforms such as Amazon to disintermediate major consumer brands in the future. Once a product has been switched for an Amazon brand, it is unlikely that you will be shown the branded good again.

Other product categories such as hair, skin care, razors and toothpaste, while harder to displace with an Amazon brand, are likely to become more competitive as the platform companies reduce the barriers to entry for newcomers.

If P&G's brands are disintermediated over time, it is likely that two investment outcomes will occur; P&G's earnings will decline as volumes and margins recede and investors will reassess the long-term price-earnings multiple that they are prepared to pay for P&G. P&G's price-earnings multiple has averaged 20 times over the past 20 years. It is not unrealistic that this multiple could fall materially in the future as its business model and its formidable portfolio of brands get disrupted. We refer to this as the terminal value risk. The investment problem is that it is impossible to know when the market will reassess the long-term prospects of businesses like P&G and the price-earnings multiple that the market will apply in the future. Our caution is that a reassessment could occur rapidly and brutally, and well before P&G's brands are meaningfully disrupted.

I believe that Friday 16 June 2017 is likely to be a historic 'Black Friday' for many retailers and possibly also manufacturers of branded household and food products. This is the day that Amazon announced that it intended to acquire the US fresh foods retailer, Whole Foods, for about US\$14 billion. In our view, this is central to Amazon's strategy to be the fulfilment company for the regular weekly shopping needs for the majority of US households. This role is currently undertaken by the grocery chains, with online retailers having a minimal presence. To break into the weekly shopping habits of consumers, it appears that Amazon has concluded it needs a compelling 'fresh' offering and a well-positioned network of stores. It will need to transform Whole Foods from an upmarket and expensive offering into a compelling fresh offering at great prices. Amazon could then use the network of 460 stores to fulfil the fresh needs of Amazon customers in store and leverage the store network as collection points for regular shopping items. It is plausible, and even likely, that Amazon could loss-lead on the 'fresh' offering to make it compelling for customers to do their weekly shop with Amazon. The integration of Amazon's fulfilment centres, Amazon Prime offering, data analytics, technology and now a physical network of stores with a compelling fresh offering potentially puts Amazon at the centre of US shopping habits. The pace and scale of disruption is accelerating.

In our view, looking in the rear vision mirror will tell you little about which businesses will do well in the future. It is more important than ever to look out the windshield and think about how technological changes could alter business models in the future.

## Picking the technology winners

An important lesson is that picking winners from technological disruption may be less obvious than it appears. Take the example of Uber, the world's leading car-hailing app. Uber is reportedly one of the most valuable start-up companies, having a private market value above US\$60 billion. Uber has apparently attracted some of the world's most renowned investors to fund its business. I find this perplexing because the Uber business model is risky and has a high probability of failure. Its business reportedly uses a lot of cash, thereby requiring 'cash injections', and the funding model to attract these injections requires an ever-increasing 'valuation' to

encourage the next investor to provide cash on the expectation that the value at the next funding round will increase. Without access to more funding, the business may not survive.

Uber's business model is a classic network business that requires a large local pool of owner-drivers and a larger number of users. Uber is spending billions of dollars per year in building its network of owner-drivers. The risk with the Uber business model is the likely emergence of autonomous driving. If autonomous driving becomes a reality, one side of Uber's network will collapse. A network of owner-drivers is a high-cost solution compared with a fleet of autonomous vehicles. We would also argue that Uber's huge number of users could be replicated rapidly by another company that had a vast fleet of autonomous vehicles. To prosper in an autonomous driving world, Uber needs two things; access to exceptionally safe autonomous-driving software; and access to a lot of capital to roll out a vast fleet of autonomous cars. We question whether Uber has either of these.

We assess that there are other companies that have materially stronger competitive advantages in autonomous driving. A critical test for autonomous-driving software is how far an autonomous vehicle can travel before the human 'safety driver' in the vehicle has to take control to avoid an accident – in what is known as a disengagement. Recent data indicates that Waymo (Alphabet's autonomous driving unit) has driven over 600,000 miles in California with an average 'disengagement' rate of slightly over 5,000 miles. In March this year, Uber's autonomous vehicles were able to drive just 0.8 miles before a safety driver needed to assume control for any reason. In California, Tesla is averaging around three miles per disengagement, Mercedes-Benz two miles, BMW 638 miles and Ford 196 miles. These results suggest Uber has the least advanced autonomous-driving technology among the major players. We believe that it is likely that only a few autonomous-driving operating systems will prevail in the longer term and the winners are likely to have the best safety records. Waymo appears to have a commanding lead and Uber appears to be a laggard.

An investment in Uber may be a bet that autonomous vehicles will not be adopted. Given the quantum of investment and advances in autonomous-driving technology, this appears unlikely.

## Portfolio performance

The past 12 months was a buoyant time for global stocks. They rose to record highs as US companies generally posted higher-than-expected earnings, the internet mega-caps rallied on their strong results and bright prospects, the shock victory of Donald Trump in the US presidential elections fanned optimism that his pro-growth policies would revitalise the US economy, the Federal Reserve signalled the US monetary policy would only be tightened at a gradual pace, deflation eased as a concern for the world economy, the eurozone economy improved, mainstream parties held off populists in the European elections, China's threat to the world economy receded and emerging countries overall expanded. The MSCI World Net Total Return Index rose 18.20% in US dollars over the 12 months.

The MFG Asset Management Global Equity strategy recorded a gross return of 20.66% for the 12 months in US dollars. The largest contributors to performance in US dollars included the investments in Apple (which contributed 3.09% to returns), eBay (+1.84%) and Microsoft (+1.72%).

Apple advanced 53%<sup>1</sup> over the 12 months when it became the first US company to record a market value above US\$800 billion. The company released better-than-expected result updates that showed iPhone popularity remains high and the number of iPhone users and associated services business is growing at double-digit rates. eBay surged 49% over the 12 months thanks to improved revenue and profit guidance and evidence the company is benefiting from user-experience investments. Microsoft jumped 38% over the 12 months reflecting business results that are benefiting from the shift in enterprise expenditure to cloud computing.

The stocks that detracted the most in US dollars included investments in CVS Health (which detracted 0.63%) and Target (-0.35%).

CVS Health fell 14% over the 12 months amid a decline in same-store sales and after warning that network changes would result in the loss of script sales in its pharmacy segment. Target declined 23% over the 12 months. (The stock was sold during February 2017.) Target's poor performance was due to a profit warning when the company released its fourth-quarter earnings when operating profit expectations were reduced by US\$1 billion to reflect the impact of management initiatives to contend with a more competitive retail environment.

## Outlook

We are cautious about the outlook for equity markets. Abnormally loose monetary policies have distorted asset markets, particularly so-called bond-proxy equities, which are sensitive to movements in longer-term interest rates. The Federal Reserve is likely to gradually normalise this position as US economic growth continues. The trajectory of any tightening, however, will depend on whether or not inflation stays under the Fed's 2% target. If North Korea were to dramatically advance its capability to a nuclear intercontinental ballistic missile, this could be destabilising. While China appears to have control over the yuan and capital flows, there is a risk Beijing could lose its battle to prevent a disorderly drop in the currency. There is a heightened risk that US trade protectionist policies could become more common and destabilise global growth. There is a risk that President Donald Trump could make a major mistake in the resetting of the US's relationship with China and in dealing with the nuclear threat from North Korea.

## Portfolio positioning

Notwithstanding the uncertainty surrounding stock markets, we are confident about the long-term outlook for the investments in our portfolio and the portfolio's risk profile. Some observers consider that our portfolio is essentially a US-centric portfolio and, therefore, primarily a view on share markets in the US or the US economy. This is a simplistic view and not how we view the portfolio. At 30 June 2017, our portfolio comprised 16 multinational businesses (13 companies listed in the US and

<sup>1</sup> Movements in stock prices are in local currency.

three listed outside the US), four US domestic businesses, two UK businesses and cash in US dollars. We hold the cash in US dollars for defensive purposes. The 16 multinational businesses represent 65.6% of the portfolio at 30 June 2017 and can be broken down as follows:

- **Multinational digital-platform businesses and software businesses** representing 30.5% of the portfolio at 30 June 2017
- **Multinational food, food distribution and quick-service restaurant companies** representing 16.9 % of the portfolio at 30 June 2017
- **Multinational payments-platform businesses** representing 12.0 % of the portfolio at 30 June 2017
- **Multinational healthcare and pharmaceutical companies** representing 6.2% of the portfolio at 30 June 2017.

We are seeking a portfolio of the most-attractive and highest-quality multinational businesses irrespective of which stock exchange they happen to be listed on. We have chosen to invest in Nestlé (listed in Switzerland) over multinational food companies listed in the US, and chosen to invest in Oracle (listed in the US) over a peer company such as SAP (listed in Germany) purely on valuation grounds. It is simply irrelevant to us that 13 out of 16 of our multinational investments happen to be listed in the US. It is also worth noting that we estimate about 40% of the collective pre-tax earnings from these 16 multinational investments are generated from the US, yet through a simplistic lens of viewing these multinational investments by share-market listing, 85% of these investments by value would be regarded as sourced from the US. This is clearly not correct from an economic perspective.

It is worth commenting on the four US domestic businesses that are in the portfolio (Lowe's, Wells Fargo, CVS Healthcare and HCA), which represented 14.6% of the portfolio at 30 June 2017. We view each of these investments as attractively priced and their selection reflects our views on the US housing market, US interest rates and the outlook for US healthcare. Our analysis indicates that collectively these investments are trading on a one-year forward average price-earnings multiple of 13.6 times, which is a substantial discount to the S&P 500 Index (17.5 times) and the MSCI World Index (16.5 times) at present. We consider we have a modest exposure to US domestic investments and believe that they are attractively priced.

**Table 3: Top holdings of the MFG Asset Management Global Strategy as at 30 June 2017.**

Security	MFG sector	Weight (%)
Apple	Information technology	7.2
Alphabet	Internet & ecommerce	5.9
Visa	Payments	5.1
Facebook	Internet & ecommerce	4.9
Lowe's	Consumer discretionary	4.5
Microsoft	Information technology	4.5
Wells Fargo	Financials	4.1
Oracle	Information technology	4.0
eBay	Internet & ecommerce	3.9
Nestlé	Consumer defensive	3.9
Other	-	37.0
Cash	-	15.0
<b>Total</b>		<b>100.0</b>



Hamish Douglass

Chief Executive Officer, Chief Investment Officer and Lead Portfolio Manager

25 July 2017

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The MSCI World Index (Net) is a free-float adjusted market capitalization weighted index that is designed to measure the equity performance of 24 developed markets. Index results assume the reinvestment of all distributions of capital gain and net investment income using a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties.

## GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS®) DISCLOSURE

Magellan Asset Management Limited, doing business as MFG Asset Management in jurisdictions outside Australia and New Zealand, (MFG Asset Management) claims compliance with the Global Investment Performance Standards (GIPS®)

For the purpose of complying with GIPS, the Firm is defined as all discretionary portfolios managed by MFG Asset Management.

The Global Equity composite is a concentrated global equity strategy investing in high quality companies (typically 20-40 stocks). High quality companies are those companies that have sustainable competitive advantages which translate into returns on capital materially in excess of their cost of capital for a sustained period of time. The investment objectives of the Global Equity strategy are to earn superior risk adjusted returns through the business cycle whilst minimising the risk of a permanent capital loss. The composite was created in December 2011.

To achieve investment objectives, the composite may also use derivative financial instruments including, but not limited to, options, swaps, futures and forwards. Derivatives are subject to the risk of changes in the market price of the underlying securities instruments, and the risk of the loss due to changes in interest rates. The use of certain derivatives may have a leveraging effect, which may increase the volatility of

the composite and may reduce its returns.

Gross composite returns (includes the reinvestment of dividends and capital gain distributions), are net of transaction costs, withholding taxes and direct expenses, but before management fees, custody and other indirect expenses. Net composite returns are prepared by subtracting from the monthly gross returns one-twelfth of the maximum applicable to institutional investors (0.80% p.a.). A list of composites and descriptions, as well as policies for valuing investments, calculating performance, and preparing compliant presentations are available upon request by emailing [data@magellangroup.com.au](mailto:data@magellangroup.com.au)

The representative portfolio is an account in the composite that closely reflects the portfolio management style of the strategy. Performance is not a consideration in the selection of the representative portfolio. The characteristics of the representative portfolio may differ from those of the composite and of the other accounts in the composite. Information regarding the representative portfolio and the other accounts in the composite is available upon request.

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